Supreme Court, U. S.
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IN THE

Supreme Court of The United States

OCTOBER TERM, 1975

No. 75-1065

JOHN NUVEEN & CO., INC., a corporation, INVESTORS SYNDICATE OF AMERICA, INC., a corporation, and INVESTORS DIVERSIFIED SERVICES, INC., a corporation,

Petitioners,

vs.

HENRY T. SANDERS,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF PETITIONERS

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The Brief for Respondent in Opposition ("Brief in Op.")* at best gives only a superficial reply to the arguments advanced by petitioners demonstrating the need for review by this Court. Respondent's inability to meet petitioners' arguments regarding the duty of a commercial paper dealer is typified by the absence of apposite citations. Accordingly, only a few points made by respondent merit a response at this time.

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* Other abbreviations used herein are the same as those used in the Petition. The "1934 Act" is the Securities Exchange Act of 1934; the "1933 Act" is the Securities Act of 1933; and *Sanders I* is the first Court of Appeals opinion herein.

I.

The reply to petitioners' contention that the notes purchased by the class members are not "securities" within the meaning of Section 3(a)(10) of the 1934 Act merely emphasizes the infirmities in the decision below.* For example, respondent states, "The date of maturity of the note is not meaningful . . ." (Brief in Op., page 6). This concedes the fact, recognized in some decisions construing Section 3(a)(10), that the statutory exclusion or inclusion of notes based solely on their maturity has been emasculated by decisions such as *Sanders I* (Pet., page 11).

Respondent contends that the decision below will have no significant effect upon the commercial paper market, that "the great bulk of commercial paper" is exempt (Brief in Op., pages 10-11) and that "[*p*]*resumably* all such [non-exempt] investment paper is now being registered with the SEC before being sold to the public" (Brief in Op., page 8, emphasis added). Respondent's confidence in the ability of a dealer to determine the availability of an exemption (and thus whether registration is required) is neither supported by the record nor shared by movant** Lehman Commercial Paper Incorporated. The latter, with petitioners, contends that the decision below will have a significant impact, particularly with respect to the risk presented by a hindsight or retroactive determination that paper reasonably thought at the time of sale to be exempt was actually non-exempt, because of facts not known to the dealer. *See* Pet., pages 24-26; brief of Lehman Commercial Paper Incorporated, amicus curiae, pages 12-14. *See also* brief of Securities Industry Association, amicus curiae, pages 10-11. Petitioners submit that review by this Court is necessary to resolve such dilemmas.

* The suggestion that, as a matter of policy, this Court should not now review an issue that was the subject of an interlocutory appeal (Brief in Op., page 6) is at odds with the long-standing practice of this Court. *See* Pet., page 9 at note *, and *Hamilton-Brown Shoe Co.*, v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

** Lehman Commercial Paper Incorporated and the Securities Industry Association have each filed motions for leave to file a brief as an amicus curiae. These motions have not yet been ruled on. References herein are to the briefs which the amici curiae have sought leave to file.

II.

Respondent never meets petitioners' arguments (Pet., pages 18-21) demonstrating that the court below concluded too much from its determination that Nuveen was within the 1933 Act definition of "underwriter", a misunderstanding on the part of the court foreshadowed in the portion of the oral argument quoted by respondent (Brief in Op., pages A2-A3). As indicated by petitioners at oral argument below and in the Petition, the statutory definition of "underwriter" is meaningful with respect to certain provisions of the 1933 Act but has no significance under Rule 10b-5.

Respondent contends that Nuveen was properly held liable for failing to do what "[u]nderwriters customarily do", citing three cases involving registered public offerings (Brief in Op., page 14).* The decision below cannot be supported by repeating its errors.

III.

Respondent's remaining arguments may be dealt with summarily.

A.

Respondent attempts to justify the duties imposed upon Nuveen on the ground that Nuveen sold the notes on the

* Similarly, in opposing the motion of the Securities Industry Association as amicus curiae respondent refers to "[s]tandard underwriting procedure" (Objections to Motion of Securities Industry Association, page 2).

basis "that there should be no question but what the paper will be paid at maturity" (Brief in Op., page 9). In relying on that statement (App. 2), the Court of Appeals treated it as if it had been a representation communicated to purchasers rather than, as it was, merely a statement made by the head of the Nuveen commercial paper department to the president of Winter & Hirsch when he explained why Nuveen ceased selling Winter & Hirsch commercial paper (Pet., page 6). It was an expression of Nuveen's ultimate goal in the sale of commercial paper and did not constitute any assumption of an obligation such that failure to meet the goal could result in civil liability.

B.

Respondent's effort to distinguish *Ernst & Ernst v. Hochfelder*, 503 F.2d 1100 (7th Cir. 1974), *cert. granted*, 421 U.S. 909 (1975) (No. 74-1042) (Pet., pages 12-15; Brief in Op., page 13), is without merit. The cases are not as dissimilar as respondent suggests. Ernst & Ernst was without knowledge of the fraud at issue in that case (503 F.2d 1104); in this case Nuveen had no knowledge of the fraud perpetrated by an issuer and its accountant, a lack of knowledge which the Court of Appeals recognized was "honest". For that reason and the reasons stated in the Petition, the decision in *Ernst & Ernst* will have a direct bearing on, and may be dispositive of, this case.

C.

Any contention that the decision below places no duty on a dealer in commercial paper to verify the accuracy of the report of the auditor but only requires an interview of him (Brief in Op., pages 14-15) is without support in the opinion

below and is contrary to the facts of the case.* The decision below expressly held that, despite Nuveen's mistaken but honest belief in the accuracy of the financial statements (App. 1), it should have examined the auditor's working papers (App. 4). If the decision stands, the dealer who honestly relies on certified financial statements of the issuer and has no reason to suspect fraud, but who fails to take any step which might possibly occur to one "with a question of fraud in mind" (App. 10), can never be sure that he has fulfilled his Rule 10b-5 duties as an "underwriter". *See* brief of Securities Industry Association, page 16.

The decision below has been widely understood as creating a very broad responsibility.** Review should not be denied simply because in respondent's view it is capable of a narrower reading.

D.

In asserting that the decision below is sustainable on alternative grounds respondent begs essential questions. The alternative grounds which are predicated on violations of provisions of the 1934 Act fall if the commercial paper at issue was not a security or if a showing of *scienter* is required to establish liability. The lone ground under the 1933 Act, that Nuveen is liable under Section 12(2), was rejected by the Court of Appeals since the District Court made no supporting findings (App. 6), as respondent recognizes (Brief in Op., page 15).

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* The record shows that when a meeting was held between a lender to Winter & Hirsch, the First National Bank of Chicago, and Lieber, Bleiweis after the lender heard rumors of a problem at Winter & Hirsch, the auditor was able to allay any concern expressed by the representative of the lender, a senior bank officer (App. 23-24).

** New York Law Journal, 1/21/76, pages 1-2; Securities Regulation & Compliance Bulletin, pages 2-4 (Prentice Hall 12/18/75); Securities Regulation and Transfer Report, pages 1-2 (Management Reports, Inc. 12/18/75). *See also* brief of Securities Industry Association, amicus curiae, pages 13-14.

CONCLUSION

For the reasons given herein and in the Petition for Certiorari, we pray that the writ be granted.

Respectfully submitted,

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